

INDUSTRIAL SECURITIES
AN OUTLINE

CLINTON COLLVER

INVESTMENT BANKERS ASSOCIATION
OF AMERICA



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INDUSTRIAL
SECURITIES

INDUSTRIAL SECURITIES

BY
CLINTON COLLVER

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New York
Doubleday, Page & Company
for
Investment Bankers' Association
of America
1921

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INVESTMENT BANKERS' ASSOCIATION
OF AMERICA

Education Committee

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PREFACE

Recognition that ours is a highly developed industrial nation has been belated. Only in the past few years have industrial securities received favor as investments.

Owing to these facts and to the lack of accepted standards of industrial accounting, very little published material is available in regard to the analysis of industrial securities aside from a book which is referred to many times in the following pages. However, since it follows that a company which deserves good credit should have securities worthy of consideration, texts on credit contain helpful information, as well as texts on accounting.

The student who approaches the subject of industrial security analysis after obtaining a good working knowledge of accounting is at a decided advantage, although the material presented herewith has been set forth in a simple form easily to be grasped by any one who has a general knowledge of business and finance.

Special effort has been made to treat at some length reserves, funds, surplus, book value,

and other such subjects which have been less generally understood than others.

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It is presumed that the reader has covered the field indicated by the "Courses of Study in Corporation Finance and Investment" prepared by Hastings Lyon and published by the Education Committee of the Investment Bankers' Association, obtainable from the Secretary of the Association, 111 W. Monroe Street, Chicago. Suggestions as to the use of the following pages will be found in the introduction of the outline in Corporation Finance and Investment.

Cross references will be found in the following chapters e.g., "See also XV, Page 91." Such a citation refers to a chapter and page of the following and is particularly used to help the reader who is looking up a special phase of industrial securities.

While some material following has not been published before, by far the most of it consists of digests and references accompanied by citations. For convenience the name of the author and pages only are given usually. A complete bibliography with names of authors in alphabetical order will be found on pages 101-103. Some four authors have written more than one book which has been found useful. The citation will show which book is referred to—for example: *Tovey*—Prospectuses, or *Tovey*—Balance Sheets.

Citations from the Annals of the American

Academy of Political and Social Science, Mch., 1920, number, are referred to: *Annals—Moody Reed*, or *Lyon*, showing the author of the chapter referred to.

On pages 104-105 immediately following the bibliography will be found suggestions as to sources of information in regard to *specific* corporations.

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INDUSTRIAL
SECURITIES

I

Introduction

1. *Varieties of Industrials—Magnitude.*
Collver, 13-15.

Subdivisions of manufacturing.

Subdivisions of distributing and trading.

Construction.

Mining not considered except in cases in which mining operations are only a part of an integrated business.

2. *Industrials Compared with Railroads.*
Annals—Moody, 76; *Collver*, 9-11.

Stability of earnings.

Elasticity of capital—possibility of expansion through diversification of products and expansion of markets.

Permanency of demand.

Standardization of activities and methods.

Difference in business and financial structure and financial methods.

3. *Advantages of Large-Scale Enterprise.*
Collver, 17-20.

Ease of financing.

Ability of securing best technicians and executives, yet not dependent upon any one.

Advantage in advertising.

Location.

Improved, economical, and standard methods.

Experimental and development work.

Purchasing or producing raw products.

Selling—including exporting.

By-products.

Strikes, accidents, etc.

Average demand.

4. *Development of Large-Scale Industrial Enterprises and Market for Their Securities.*

Large-scale enterprise result of improvement in transportation and communication.
Collver, 17.

Methods of eliminating destructive competition: agreements, business trusts, associations, pools, combination trusts, community of interest organizations, complete consolidation and holding companies. Amalgamations and mergers. Effect of competition.

Haney, 100-255; Mead, 348-374; Dewing, 518-529. For collateral reading see Dewing, 529-546.

Ripley, Introduction. For collateral reading the entire text is interesting.

Influence of speculative possibilities. Development of a market for conservative industrial securities.

Annals—*Moody*, 73-75.

5. *Limitations of Large-Scale Enterprise.*

Through too rapid and easy enlargement of capitalization, a business may be expanded dangerously, either because of subsequent unfavorable general conditions or because those in control are not big enough calibre to make a really large enterprise profitable.

A large enterprise is sometimes a shining mark for ignorant or self-seeking political prosecution.

Decreased responsibility sometimes felt by subsidiary officials—organization may be so large as to resemble political government, making applicable part of the arguments against municipal ownership.

Decreased responsibility sometimes felt toward the stockholders.

Increased possibilities of manipulation and fraud.

Haney, 234-237; *Dewing*, 558-566.

See also V. 2A. Pages 27-28.

II

Classes of Industrial Securities

1. *Distinctions between Stocks and Bonds.*
Chamberlin, 29-37. 488.
2. *Kinds of Stocks.*

Different kinds of Stocks—common and preferred—their rights and special features.

The "Stock Exchange Business," 24-25.
"Courses of Study in Corporation Finance and Investment," 9-10; *Lough, 70-104; Jordan, 11-22.*

Founders or Managers Shares. Comparatively new in this country. Usually are common shares given or sold to managers or employees. Sometimes provided that the shares cannot be sold except to the company. These shares often precede ordinary common in case of liquidation. Often these shares are entitled to a certain proportion of *entire* distribution of surplus earnings. Object in issuing Founders or Managers shares to give all incentive to those in charge of a corporation to develop the business. Perfectly fair unless the percentage of total profits to

these shares is too large. Sometimes all common shares receive stated percentage, e.g., 7 per cent.—then Founders or Managers shares receive a certain percentage, say 20, of any further distributions.

See *Lough*, 83. *Tovey*—Balance Sheets, 15-17. For Provisions of typical Managers Shares see *Gerstenberg*—Materials, 1013.

Additional citations on No Par Stock: *Lough*, 95; *Collver*, 133. Law of New York State: *Gerstenberg*—Materials, 43-50.

Bonus Stock: *Lough*, 91.

Voting Trust Certificates: *Lough*, 102-104.

For typical agreement see *Gerstenberg*—Materials, 91-97.

Cumulative Voting: *Lough*, 95-99.

3. *Kinds of Bonds and Notes.*

The various bases of classification, covering all classes of security issuers, including industrials. *Chamberlain*, 69-114. *Annals*—*Lyon*, 6-11; *Jordan*, 22-30; *Lownhaupt*, 14-35.

It is notable that the forms of industrial bonds are few and simple in comparison with those issued by railroads. A second mortgage industrial bond is not common. In security the industrial bond usually jumps from a first mortgage to a debenture. Seldom does an industrial have more than three or four issues of bonds and notes as against as high as fifty to sixty for some railroads. *Annals*—*Moody*, 76-77.

III

Provisions of Preferred Stocks

The Industrial Securities Committee of the Investment Bankers' Association of America made in 1919 a most helpful report in regard to preferred stocks and their covenants. This is given below complete.

By MAYNARD H. MURCH, CHAIRMAN
Of Maynard H. Murch Co., Cleveland

The Industrial Securities Committee desires to direct the attention of the members of the association to the subject of preferred stock covenants. We have not made a statistical analysis of the sale of preferred issues, but every dealer knows how great the volume has been during the last two or three years and the tremendous rate at which it continues to grow. The committee believes that there are immediate problems for the association to consider in order to obtain the best results from this new department of the investment securities business.

The preferred stock method of financing has been employed, as a rule, by established corporations, for the purpose of raising capital without going into debt, although, in connection with common bonuses, it has been used frequently for new enterprises. Corporations have been attracted by this method of cleaning up old debts and furnishing additional funds without the creation of other

debts, as a means of paying up bank obligations and clearing property of mortgages. The public has been attracted by the substantial investment values that have been provided in preferred stocks in the way of liberal income, tax exemptions, and protective features, as well as by the general advantages to the corporation. Thus fostered by the favor of both issuer and purchaser the movement has grown and rolled up in surprising volume.

In order that the best results may be obtained from this movement for the corporation, and therefore the best results for the investor, the committee believes that the best practices to be followed are along the general theory of substituting liens on the management, with maturities payable out of profits, for liens on tangible property, with fixed maturities, properly safeguarded by covenants which will keep the tangible property intact and enable the preferred stock, if the management should fall into the hands of the preferred holders, to get direct access to the affairs of the corporation before irreparable damage has been done by the dissipation of working capital and the creation of excess debts.

If this theory is carried out by giving the investment house from which the investor purchases his securities monthly financial statements covering assets, liabilities, sales, collections and profits, so that every important change in the affairs of the corporation may be known at once, and representation on the board of directors with provision for monthly meetings; and the preferred stockholders be given authority to change the management through controlling stockholders' meetings in the event of default in any of the important restrictions of the issue, more desirable results can be obtained in many cases, both from the standpoint of the corporation and the investor, than by financing through the creation of debts; provided, however, the investment house attends conscientiously to its duties in watching the issue. The last provision is of the utmost importance, and requires particular emphasis during such times as these when industrial houses are apt to be too busy with new issues to bother about the old ones.

As a part of this report we have tabulated various methods which investment houses have pursued in attempting to obtain the foregoing results. A few of the important items in regard to the protection of working capital, redemption, voting power, and the issuance of prior lien securities deserve special comment.

REDEMPTION—If preferred stocks are to be considered investments they must observe the rules of redemption. Where so much dependence is placed upon the personal element which is certain to change every few years, and may change overnight, the redemption clause is one of the most important, but because of state and federal laws regarding taxes, and the necessity of considering preferred funds as a more or less permanent form of capital, the amounts and times of redemption cannot be fixed, except in relation to earnings, and there can be only partial compliance therefore with the recognized investment rules of redemption. The most important points in connection with the redemption of preferred issues are the time of beginning redemption, the amount to be redeemed annually, and the price at which redeemed. A corporation which has been refinanced for the purposes of extending its business or the construction of new plants should be permitted to have the use of the new funds without redemption requirements until these funds have commenced producing; otherwise the redemption charge is a burden on the old capital of the company. We consider it well, therefore, to allow the corporation, under such circumstances, a reasonable period, to be determined by the conditions of each case, before the redemption clause is in full operation. Another way of treating this point is to specify a smaller amount to be redeemed during the first and second years.

The total amount to be redeemed each year depends upon the nature of the business, the character of its assets, whether wasting or growing, its earning power, and its capital requirements.

The price at which preferred stocks should be redeemed depends upon circumstances which vary from issue to issue,

but this feature is determined largely by the investment values of the security. A highly speculative issue may be retired at a larger price than an issue containing substantial investment values. Preferred stockholders of a corporation engaged in a hazardous line of business are entitled to a good profit over and above the regular rate of dividend on their stock in the event that the prosperity of the issuing corporation, based largely on the use of the preferred stockholders' money, enable it to retire the issue. Substantial non-speculative issues naturally bear a smaller redemption price, except in cases where an unusually high rate of dividend is provided, as has lately been the case in several known preferred issues.

It has been customary to redeem on dividend dates only, and to require from 60 to 90 days' notice. There is no particular reason why preferred stocks should be redeemed on dividend dates, because this requirement does not offer any particular advantage, either to the issuing corporation or to the investor, except a small matter of book-keeping; nor does long-time notice seem essential from the standpoint of the investor, if the redemption premium be sufficient. Such notice certainly is not essential from the standpoint of the corporation. It seems fair to all parties concerned, therefore, that preferred stocks should be called upon reasonable notice, say, 30 days prior to any given date. If redemption may take place only upon a dividend date, there might be several months' delay before legitimate financing might take place, where the element of time was of great importance.

NET CURRENT ASSETS—In our opinion the covenant in regard to the maintenance of net current assets is one of the most important to be provided in the issuance of preferred stock. It is the deficiency of working capital which is ordinarily responsible for the issuance of new securities. This deficiency may be the result of rapidly expanding business or of the construction of new buildings for the housing of old business or the result of losses from the operation of the business, accidents, bad credits, etc.

A corporation having plenty of working capital seldom

is required to sell new securities, excepting for expansion or extraordinary purposes. Any covenant which has to do with the maintenance of the proper amount of working, or current capital, is therefore of the utmost importance. Most preferred stock issues read that the amount of net current assets shall be equal to the amount of outstanding preferred stock. Our examination of many cases where the covenant is worded in this manner fails to disclose any particular relation between the current capital requirements of the business and the amount of the preferred stock outstanding, although in some cases there is an accidental relation, notice of which has led a great many corporations to provide in their issues that the amounts shall be equal.

As a matter of fact, a corporation may have only 50 per cent. of its preferred stock issue represented by net current assets and still be comfortably supplied with working capital. This matter depends entirely upon the nature of the business, and frequently one of the important determining facts is the length of credits. In a certain line of business where credits are twenty-four days long, working capital requirements are much smaller than where they are 45 days. While it may answer the purpose in a haphazard sort of way to fix the amount of net current assets to be maintained at 100 per cent. or 125 per cent. of the outstanding preferred stock issue, this is at best a makeshift method and may be absolutely unfair to the corporation as well as to the holder of preferred stock, except that it provides enough current assets to liquidate preferred stock in event of dissolution of the company, which the investor does not consider as one of the probabilities when he buys his stock. From the standpoint of operating the business the covenant in regard to the maintenance of net current assets should be drawn after determining the required amount of capital for a certain volume of business and by careful inspection of the records of the business for a long period of years. Such examination will clearly show how much business may be safely done per dollar of capital under ordinary conditions.

The committee believes that it adds greater safety to the interest of the preferred stockholder to provide just

enough working capital to run the business safely, rather than to burden the corporation by providing a great deal too much, as may be the case if this important point is settled by the rule of thumb method of stating that net current assets shall be equal to the outstanding preferred stock issue. A survey of the records of any business may determine that the amount of working capital required to keep the corporation out of excessive debt may be considerably in excess of the outstanding preferred stock issue.

The method of determining net current assets should be carefully provided in the covenants of the issue by reciting the items which shall be included, as well as those items which shall be deducted. Without this detail in the preferred stock contract there is certain to arise a constant dispute in regard to the matter of working capital.

ISSUANCE OF SENIOR SECURITIES—The issuance of securities having priority over preferred stock is of utmost importance to the preferred stockholders, and should be treated in a broad and positive manner, so as not to prevent the corporation from turning around in case of emergency; at the same time make it necessary that such securities may be issued only after full consideration of all the interests at stake, and with the written consent of a proper proportion of the amount of outstanding preferred stock.

To provide that the corporation may not issue securities of prior lien under any circumstances would be to defeat the theory of preferred stock financing, and might bring disaster upon some preferred stockholders whose interests could be well protected by the proper issuance of senior securities issued under the supervision and with the consent of the preferred stockholders.

One of the great differences between preferred stock and mortgage financing is that in a properly drawn issue of preferred stock, the corporation starts out with a clean sheet, without mortgage obligation, and with only a comfortable amount of current debts, and when the day of serious emergency arises and financing through preferred or common stocks is impossible, there is still left open the opportunity

of creating a mortgage on fixed property. If this door is closed, disaster might be certain to follow to preferred stockholders, whereas the creation of a mortgage under the supervision of the preferred stockholders might be ample protection for their investment.

It is impossible, of course, to prevent a corporation from owing current obligations up to a certain reasonable amount, which amount is ordinarily fixed by commercial banks at 50 per cent. of the total current assets. But the question often arises as to whether or not in a tight money market it is not advisable to permit the conversion of bank loans into notes of a long maturity. A great majority of preferred stock issues provide that without the consent of a certain proportion of the preferred stock issue no obligations having a longer maturity than one year from date shall be permitted. As between 90 day paper, for the payment of which the corporation is being pressed, and 3 year paper, which is riding comfortably, there can be no choice as far as the corporation itself is concerned, but from the standpoint of the preferred stockholder it is not always safe to permit a corporation to convert its bank loans to long-time obligations, although thereby there may be created no increase in the total amount of indebtedness, because at that stage of the company's business, where this conversion seems advisable, it may be wise for the preferred stockholders to make a new survey of the situation to determine whether the failure of the corporation to keep out a reasonable amount of 90 day paper is due to some important fact of which recognition should previously have been made. On the other hand, such conversion may be advisable if the total amount of debt is otherwise carefully guarded.

This is a difficult point to discuss with the manager of a corporation, who ordinarily can see the difference between short-time and long-time notes as a matter of time only, with the preference for the long time, but if this point of conversion is left uncovered the preferred stockholder may miss an opportunity of compelling the common stockholders to assist in financing the corporation up to the point where there is a reasonable balance between the

amount of money furnished by the preferred stockholders and the common stockholders and the commercial banks. No harm is done to preferred stockholders by the allowance of purchase money mortgages, subsequent to the issuance of preferred stock, where the amount of mortgage is for only a reasonable portion of the property purchased.

Restrictions on the creation of prior lien securities should also include the guaranteeing of the credit obligations or securities of subsidiary or allied corporations, whatever may be the consideration for which such guarantees might be created. Even in cases where the entire capital stock of a subsidiary or allied corporation may be owned by the issuing corporation, it is important for preferred stockholders to provide that the relations between the two corporations shall be maintained on standard financial, business, and legal lines. Otherwise, preferred stockholders may some day wake up to find that their corporation has been lending raw material or money or credit to a subsidiary corporation, and the subsidiary corporation may be disposed of by the directors of the issuing corporation in a way that is disadvantageous to the holders of the preferred stock issue. It is impossible for preferred stockholders to guarantee themselves against the most infamous forms of mismanagement and milking, unless the covenants of their contract carefully cover the matter of relations with subsidiary corporations.

VOTING POWER AND PENALTIES—It has been the habit of the old-time bond investor to consider preferred stocks as “easy going,” and to the extent that the covenants are not properly supported by sufficient voting power to enforce them, this criticism is true. The committee has found a surprisingly large number of issues which do not provide voting power sufficient to give the preferred stockholder any authority whatever in the event of default in any of the important covenants of the contract. Except for the fact that the preferred stockholder obtains a more liberal income from the issuing corporation than the bondholder, there is no reason whatever for surrendering his right to register properly a protest in the event

that his investment is damaged. Yet in many cases the preferred stockholder is left without voting power, or with only sufficient voting power in the event of default to put him on an equal footing, or what appears to be an equal footing, with the common stockholder who is responsible for the default.

Equal voting power, between preferred and common stock, simply means that the preferred stockholder has an admission ticket which is no good, because the common stockholder, by the purchase of a few shares of the preferred, easily accomplished when trouble is brewing, has complete authority to continue his administration and the abuses which have impaired the interest of the preferred stockholder. In the event that these abuses or accidents, whichever may be the proper term under the circumstances, have been beyond the control of the common stock management, the preferred stockholder with a larger vote than 50 per cent. would probably make matters worse by attempting to exercise his authority, but in all other forms of investment where the income is limited, the investor is given the opportunity of deciding what shall be done about the payment of the obligations due him, and in the case of preferred stocks, if he so chooses, he has a free hand to caucus his interests with the common stockholder for the consideration of proper remedies, and it is not necessary, although it may be his right, that he should upset the management which has been unfortunate rather than incompetent.

In the case of incompetent management, which threatens the security of the preferred stockholder's investment, no remedy is sufficient except voting power which controls without question the proceedings of the stockholders' meeting. A director once elected cannot be removed until the expiration of his term, and if he represents the common stockholder as against the preferred, it is not at all probable that he will resign. It is therefore difficult for the preferred stockholders, even with a controlling vote, to get immediate control of the executive machinery of a corporation, but a stockholders' meeting, which is held at the first discovery of signs of danger, certainly will have a proper re-

straining effect, and perhaps put the preferred stockholders in position to resort to ordinary processes of law which would be sufficient until the holding of the annual meeting.

It does not appear to the committee to be so much a question as to what the proper voting power should be, because every investment dealer wants it to be sufficient for the protection of his clients, but it is more a question of how to enforce the proper remedies with an unfriendly board of directors still in control. This has been accomplished in many cases where the common stock is closely held, and agreements to that effect more readily obtained, by providing that in case of certain aggravated defaults the preferred stockholder should be permitted to call meetings of stockholders and to obtain immediately the resignation of directors so that they might proceed forthwith to the election of their own officials. Upon the correction of the default, the common stockholder is again returned to authority. This remedy is effective, because it is quick; it saves waste of time and property and prevents the disintegration of the business. It is the extreme measure as contrasted with the almost useless provision of equal voting power, and the extent to which it should be employed depends entirely upon the circumstances surrounding such issue.

The committee recommends that in the great rush to purchase preferred issues the members of the association do not overlook the important matter of providing proper voting penalties for the enforcement of the covenants of the contract. The present preferred stock movement will finally be declared a success or failure as proper voting control is provided for the protection of the preferred stock buying public.

The committee acknowledges the assistance of Mr. Luigi Criscuolo, of Merrill, Lynch & Company, in the preparation of the following tabulation of preferred stock covenants in common use:

MAINTENANCE OF NET CURRENT ASSETS

Amount usually fixed at certain per cent. of preferred stock outstanding, depending upon requirements of busi-

ness, ranging from 50 per cent. in cases where credits are short and inventories small, to 200 per cent. in cases where fixed property is rented and credits long and inventories large.

Sometimes fixed at amount sufficient to liquidate preferred stock issue without reference to capital requirements of business.

Usually stipulated what commercial current items shall be included, what prices allowed on all classes of merchandise and what reserves and obligations deducted.

Penalty for violation of agreement usually severe.

VOTING POWER AND PENALTIES

In case of default in principal covenants, preferred stock usually has voting power, ranging from 50 per cent. to 100 per cent., but some issues provide equal share for share vote with common at all times. Voting power usually terminates with correction of default. Laws of each state make various provisions necessary.

RESTRICTION OF SENIOR SECURITIES

Provision made that, without securing permission of holders of certain proportion (two-thirds or three-quarters, more or less) of preferred stock outstanding, the company may not:

1. Create any stock which has prior or equal charge on earnings or assets.
2. Create any mortgage on property of company or issue any bonds secured thereunder, except purchase money mortgages.
3. Issue or guarantee any bonds, notes, or other evidences of debt which mature later than one year from date of issue.

DIVIDEND PROVISIONS

No dividends to be paid on common stock until all accrued and unpaid dividends on preferred stock shall have been paid, nor unless net current assets restrictions have been fully complied with.

No common dividends to be paid until foregoing provision has been complied with and further until certain amounts have been set aside for:

1. Retirement of certain proportion of preferred stock each year.

2. Creation of surplus fund to be used as guarantee fund for dividends or retirement charges on preferred stock.

In case of default in dividends on preferred stock, holders of same are given authority to elect a majority of the board of directors until such time as default has been cured. In some cases, where preferred holders have no voting power, they are given equal power with common stock until default is cured.

After preferred stock has received a specified amount and the common stock a specified amount, the balance is to be declared:

1. Equally divided between preferred and common.
2. Given to the common alone.
3. Smaller proportion given to preferred than to common.

SUBSCRIPTION RIGHTS

If any additional issue of common stock shall be made by company, preferred stockholders shall be given privilege of subscribing to same ratably with common stockholders.

In some cases, this provision is expressly waived and only common stockholders are given this right.

RESTRICTIONS AS TO CHANGE IN BUSINESS

Without consent of holders of a certain amount of preferred stock (usually 75 per cent.), the company may not:

1. Change purpose for which the company was organized.
2. Dispose of the assets and business in entirety.

DISTRIBUTION OF ASSETS UPON LIQUIDATION: WHETHER VOLUNTARY OR BY REASON OF BANKRUPTCY

Upon dissolution, liquidation, consolidation, or merger, preferred stock shall be entitled to receive a certain amount

per share, usually the redemption price, plus all accrued dividends, before anything is paid on the common stock.

The amount received is in many cases larger in case of voluntary dissolution or merger than in case of bankruptcy where it is often par and accrued dividends.

RETIREMENT OF PREFERRED STOCK

Preferred stock may be retired:

1. As a whole,
2. In certain amounts, such as percentage of issue, or percentage of earnings.
3. As a whole or in part, at a certain price and accrued dividends,
 1. On any dividend date.
 2. On 30 to 90 days' notice.

Conditional on:

1. Earnings,
2. Common stock dividends.

By call or private purchase.

In some cases, when a preferred stock is called, privilege is given to preferred stockholders to convert their stock into common before a certain date.

Preferred stock is called for payment in most cases on any dividend date, it being convenient to pay the full accrued quarterly dividend for the period. This may be regarded as a drawback in cases where the company wishes to consummate a piece of financing before dividend date arrives, but three months' interval between dividends is often consumed in shaping up a financial plan.

SALE OF ADDITIONAL PREFERRED STOCK OF SAME ISSUE

Amount not to be increased without permission of holders of certain proportion of present stock, usually 75 per cent. in writing, unless following conditions are met:

1. Net current assets are—per cent. of preferred outstanding.
2. Net tangible assets are—per cent. of preferred outstanding.
3. Earnings for past 3 years were equivalent to—times

dividend on preferred outstanding including that to be issued.

These conditions vary with nature of the business financed.

SINKING FUNDS

Sinking fund of—per cent. of preferred stock outstanding is created as a charge on:

1. Net income before dividends on preferred.
2. Net income after dividends on preferred before providing for common dividends.

For retirement each year of preferred stock at not exceeding a certain price.

In certain cases, funds of this character are not to be included in current assets of the company.

The sinking fund provision is usually arranged so that in a certain number of years all preferred stock will be retired, averaging from 12 to 20 years.

CONVERSION

Often preferred stocks have the privilege of being converted into common stock at a certain time and rate. This enables the purchaser to own a stock having better security than the common stock, and having the advantage of possible profitable convertibility into common.

SURPLUS

Maintenance of surplus at certain minimum amount is important as protection against impairment of credit and ability to pay preferred dividends, usually fixed by stating that common dividends shall be payable out of earnings subsequent to certain date, or by requiring that certain relation be maintained between surplus and preferred stock charges.

TRANSFER AND REGISTRATION

In few cases only do corporations transfer their own securities. Appointment of separate trust companies or

banks with special departments for such work is advisable for transfer and registration.

AUDITS AND CURRENT REPORTS

Audits by certified public accountants, annual or more frequent, dependent upon nature of business, with inventories taken by actual count, and monthly or quarterly statements signed by proper officials.

REPRESENTATION ON BOARD OF DIRECTORS

Usually provided that investment house shall select at least one member of board of directors to represent interests of preferred stock.

DIRECTORS' MEETINGS

Monthly or quarterly meetings of directors are provided, as circumstances may dictate.

In case the corporation wishes to have the preferred issue limited to dividend of a certain per cent. per annum, the certificate should plainly state the limitation. Should state "and no more," or "never exceeding in one year." Otherwise court may construe that dividends be equally divided after preferred dividend.

"The Corporation Journal." February, 1920. Page 108.

Some cumulative preferred stock certificates provide that not only will preferred holders be given equal voting power with the common upon default in dividends or sinking fund provisions, but that in case of several, i.e., six successive quarterly dividends or two successive annual

sinking fund payment defaults, the entire voting power be vested in the holders of preferred stock.

In regard to a callable or redemption feature, it is evident that the market price of the stock is not apt, under any conditions, to advance above this figure. If other securities, i.e., long-term bonds or non-callable preferred stocks of equal merit, sell to yield equally well when a callable preferred sells around the redemption figure the holder of the latter may well consider an exchange if interest rates promise to work lower. Otherwise the holder may find his preferred stock called in at some future time and be unable to reinvest to good advantage, owing to the advance in the market of other securities.

See *Lough*, 76-82; *Collver*, 137-141.

For example of preferred stock provisions see *Gerstenberg*—Materials, 107-110.

IV

Industrial Mortgages

1. *Analysis of the Indenture.*
2. *Rights and Duties of Corporate Trustees.*

See *Lilly* for complete treatise. See also *Lownhaupt*, 140-152; *Lough*, 133-136. For text of typical industrial bond and mortgage see *Gerstenberg—Materials*, 183-254.

V

Background of Industrial Corporation Prosperity

I. *General Business Factors.*

(A) *Integration and Sources of Supplies* *Collver, 31-35; Jordan, 182-183.*

Advantage in controlling sources of raw materials.

Examples of well-integrated companies.

Limit to capital to be tied up in raw material.

Sometimes does not pay to try to control sources of raw materials. The "assembly" idea.

Difficulties in obtaining raw materials.

Integration by amalgamation.

(B) *Location.*

Location has recently become a matter of great importance to many corporations which hitherto were not vitally concerned. The drastic increases in freight rates effective September 1, 1920, have a tendency to discourage long hauls of heavy or light

but bulky raw and finished products and to encourage local manufacture. However, no conclusion can be made as to the effect of the new rates upon any one corporation without a careful analysis of the situation—and an observance as to the actual effect of the changed conditions.

Collver, 37-39; *Jordan*, 99.

Location often a matter of chance: i.e., the residence of the inventor of an article.

May or may not be of importance. Examples.

Advantage in demand from all parts of the country.

(C) *Standardization*.

Collver, 37.

Necessity in certain industries. Examples.

(D) *Fluctuation in Demand*.

Collver, 21-23, *Jordan*, 184.

Satisfy a broad, growing demand?

Sell to all classes in large volume with small margin of profit?

Affected by seasonal weather conditions?

Depend upon general prosperity?

Depend upon local or transitory conditions?

Liable to be affected by revolutionary changes in demand?

Depend upon style or fad?

(E) *Diversification.*

Collver, 23-29.

Diversification of products sometimes counteracts a tendency to swing between poverty and over-supply of business. Examples.

(F) *Competition.*

Dewing, 523-529, 561-569; *Collver*, 41-45; *Cooper*, 149-162.

Conditions of extreme competition forced the inception of early consolidation.

Advantage of monopoly was expected. Usually expectation did not work out.

Size of corporation often not of importance in consolidation.

Monopoly possible through unusual business ability, control of raw products, patents, or trademarks. Examples.

Large profits certainly invite competition.

Except in certain instances during abnormal prosperity, competition becomes more keen and profits per dollar of gross sales tend to grow smaller. Examples.

Competition of similar products derived from different raw materials.

Escape from dangerous competition by changing line of products.

2. *Factors of Management.*

(A) *Personal Equation.*

Most large industrials, like other institu-

tions, "but the lengthened shadow of a single man." Examples.

Examples of unusual success because of unusual management.

Life insurance as a protection when success dependent upon one man or a few men.

Tendency toward standardization of personnel.

Collver, 47-49; Jordan, 177.

Difficulties in securing efficient management for very large-scale enterprise.

Dewing, 559-560.

Prosperous small business may be ruined by addition of new capital.

Large-scale enterprises may have management entirely without ability. Examples.

Able management will protect itself in raw materials by hedging or buying at advantageous times—will take advantage of changes in business and financial conditions.

If a corporation has recently been recapitalized, it is important to know whether the management, if of large caliber, will remain.

Collver, 50-54.

(B) *Financial Control—Underwriters—Directors—and Standing of Stockholders.*

Importance of control, e.g., whether controlling interests, i.e., officers and directors,

are successful and trusted, and whether at least part of these men are practical men in the special line pursued by the corporation.

Strong control will often see a corporation through from economic failure to success.

Collver, 57.

Work of directors. Tendency toward demanding real service from all of them and giving them material recompense.

Lough, 37-44.

Many a promising corporation has been ruined through having its securities handled by a weak or untrustworthy security house. Perhaps the first test of a security is to see that it is sponsored by one or more strong and reliable investment firms. Moreover, it is desirable that the entire issue, if newly offered, be *underwritten*, if possible—so that the corporation may be certain of its money, although under certain conditions this is not practical.

The standing of stockholders in certain instances may be important, but not at all conclusive, as well-regarded men may be given a security, or purchase it as mere speculation, which is offered as an investment to others.

(C) *Contracts and Alliances.*

Collver, 58-59.

Relation in regard to the raw material furnishers—pleasant?

Are raw material contracts fair to all concerned and so worded as to avoid hardship to either side in case conditions materially change?

Alliances and understandings, as far as legal, with complementary or competing firms may be desirable.

(D) *Financial Policy.*

A corporation's financial policy should be judged the same as an individual's; it is no more difficult to understand. Examples of careful, conservative policy.

Over-liberal dividend policy simply an error of judgment or adopted for ulterior purposes. Stability essential to the investor.

Collver, 61-64; *Lough*, 435-457 and 478-479. *Gerstenberg*—Principles, 162-167.

Too conservative a policy not suited to the investor who requires return.

Saliers—Financial Statements, 90-91; *Gerstenberg*—Principles, 164-165.

Reckless policy of early combinations. *Dewing*, 549-551; *Collver*, 64-67.

In regard to declaring dividend see *Hatfield*, 195-232; *Lough*, 463-464; and *Gerstenberg*—Principles, 162-164.

Initial recklessness may be followed by genuine and deserved prosperity after a period of careful saving—the same as with individuals. *Collver*, 66-67.

Stock dividends. Recently many large stock dividends have been declared. Such dividends simply reduce the surplus per share of stock through increasing the number of shares. It is quite possible that the dividend drain on some corporations which have multiplied the amount of stock and maintained the dividend percentage on the whole may prove too severe in a sub-normal period of business to allow the dividend to be maintained indefinitely.

Small stock dividends, even when disbursed with some degree of regularity, usually a more conservative plan. Companies such as certain of the Standard Oils, which maintain small dividends compared with large assets and great, well-maintained earnings, can issue stock dividends of material size without endangering the regular disbursements, and a broader market results from the increased number of shares.

Stock rights. Rights to subscribe to stock are often sold. The advisability of doing so depends upon the condition of the company and general conditions.

See *Lough*, 459-463; *Lyon*, II, 193-195.

Script Dividends—Declared to maintain regular dividends while conditions are unfavorable for cash disbursements. *Lough*, 458.

Property Dividends—Division of un-

needed assets, e.g., investments. *Gerstenberg*—Principles, 167-168.

(E) *Loyalty and Coöperation.*

Collver, 55-56; *Saliers*—Financial Statements, 94-95.

Importance in industrial success. Examples of means taken by leading corporations to secure the best efforts of the entire organization.

(F) *Good Business Methods.*

Collver, 2-4.

General policies.

Accounting—including cost. A corporation must have a well-designed and executed accounting control in all departments in order that it be managed properly and adequate reports be available for stockholders.

Effect of Associations.

VI

Policy of Publicity

Examples of companies which give frequent reports to the public. New York Stock Exchange requirements and efforts for additional publicity.

Unless complete and frequent reports are available the securities of a corporation cannot be analyzed with any degree of satisfaction. Corporation officials now realize that secrecy does not prevent "undesirable speculation" but is necessary to the protection of the security holder. Investment and intelligent speculation are possible only as frequent and complete information as to income and financial condition are available. Gambling is the staking of money on the unknown.

Collver, I. 5-7; *Tovey*—Balance Sheets, 1-9.

Some underwriting contracts now provide that a reputable accounting firm, agreeable to the underwriters, be appointed, that complete and frequent statements be issued by the corporation, that at least the annual reports of income and financial condition be certified by

the chosen accounting firm, and that the underwriters be permitted to have the accountants go over the books of the corporation at any time between the annual periods.

As an additional safeguard to assure complete publicity to the security holder, it has been suggested that underwriters provide in their contract with a company issuing new stocks or bonds that the company shall furnish and file with the registrar or trustee semi-annually an audit containing Balance Sheet and Income Account certified by accountants approved by the registrar or trustee. It has also been suggested that copies of this audit be available to every security holder upon request.

Some underwriters also insist upon at least one representative on the board of directors, in order to safeguard continuously the interests of their customers. *Collver*, 203; *Murch*—See report of the Industrial Securities Committee of Investment Bankers' Association of America given in full on pages 8-22.

One large security house has suggested that corporations be obliged to report from year to year in accordance with the statements required by the New York Stock Exchange preliminary to listing.

See *Haney*, 390-392; *Lough*, 34-37. For unusually frank annual report see *Gerstenberg*—Materials, 627-662.

See also VII, Pages 35-41 and XII, 1, 2, 3, Pages 73-76.

VII

Accounts. General

1. *Lack of Uniformity in Accounting and Published Reports.*

Accounting methods are apt to differ according to the relative prosperity of a corporation. In times of unusual prosperity conditions are sometimes better than apparent from published accounts; in times of depression, less favorable.

Unfortunately no uniform systems of accounting or published reports are in use. Owing to the various kinds of industrial activity, various standard systems will be required.

Collver, 69-70; *Saliers*—Financial Statements, 20, 31.

The Federal Reserve Board, Washington, has published, in its bulletin of April, 1917, an approved method for the preparation of Balance Sheet statements with proposed Income Account, as well as a proposed Balance Sheet. This material is a reprint of information and data acquired by the Fed-

eral Trade Commission from the American Institute of Accountants. The proposed balance sheet is given on pages 36-37 and the income account on page 76. While helpful in suggestion (as is the supplementary material in the Bulletin) Balance Sheets as given in most of the corporation annual reports are in much different form, and the items will be covered hereafter more in accordance with typical practice.

For typical Balance Sheet in conventional form reasonably complete, with supporting schedules from *Collver*, 76-79, see pages 38-39. See also *Wildman*, 285-295.

Both Income Account and Balance Sheet figures are necessary for analysis. *Collver*, 75-76.

FORM OF BALANCE SHEET

ASSETS.	LIABILITIES.
<p>Cash:</p> <ol style="list-style-type: none"> 1a. Cash on hand—currency and coin. 1b. Cash in bank. <p>Notes and accounts receivable:</p> <ol style="list-style-type: none"> 3. Notes receivable of customers on hand (not past due). 5. Notes receivable discounted or sold with indorsement or guaranty. 7. Accounts receivable, customers (not past due). 9. Notes receivable, customers, past due (cash value, \$). 11. Accounts receivable, customers, past due (cash value \$). <p>Less:</p> <ol style="list-style-type: none"> 13. Provisions for bad debts. 15. Provisions for discounts, freights, allowances, etc. 	<p>Bills, notes, and accounts payable:</p> <p>Unsecured bills and notes—</p> <ol style="list-style-type: none"> 2. Acceptances made for merchandise or raw material purchased. 4. Notes given for merchandise or raw material purchased. 6. Notes given to banks for money borrowed. 8. Notes sold through brokers. 10. Notes given for machinery, additions to plant, etc. 12. Notes due to stockholders, officers, or employees. <p>Unsecured accounts—</p> <ol style="list-style-type: none"> 14. Accounts payable for purchases (not yet due). 16. Accounts payable for purchases (past due). 18. Accounts payable to stockholders, officers, or employees.

ASSETS—Cont.

Inventories:

17. Raw material on hand.
19. Goods in process.
21. Uncompleted contracts.
Less payments on account thereof.
23. Finished goods on hand.

Other quick assets (describe fully):

Total quick assets (excluding all investments).

Securities:

25. Securities readily marketable and salable without impairing the business.
 27. Notes given by officers, stockholders, or employees.
 29. Accounts due from officers, stockholders, or employees.
- Total current assets.

Fixed assets:

31. Land used for plant.
33. Buildings used for plant.
35. Machinery.
37. Tools and plant equipment.
39. Patterns and drawings.
41. Office furniture and fixtures.
43. Other fixed assets, if any (describe fully).

Less:

45. Reserves for depreciation.
- Total fixed assets.

Deferred charges:

47. Prepaid expenses, interest, insurance, taxes, etc.

Other assets (49).

Total assets.

LIABILITIES—Cont.

Secured liabilities—

- 20a. Notes receivable discounted or sold with indorsement or guaranty (contra).
- 20b. Customers' accounts discounted or assigned (contra).
- 20c. Obligation secured by liens on inventories.
- 20d. Obligations secured by securities deposited as collateral.
22. Accrued liabilities (interest, taxes, wages, etc.).

Other current liabilities (describe fully):

Total current liabilities.

Fixed liabilities:

24. Mortgage on plant (due date).
26. Mortgage on other real estate (due date).
28. Chattel mortgage on machinery or equipment (due date).
30. Bonded debt (due date).
32. Other fixed liabilities (describe fully):

Total liabilities.

Net worth:

34. If a corporation—
 - (a) Preferred stock (less stock in treasury).
 - (b) Common stock (less stock in treasury).
 - (c) Surplus and undivided profits.

Less—

- (d) Book value of good will.
- (e) Deficit.

Complete Balance Sheet
THE MONTVILLE MANUFACTURING COMPANY
Balance Sheet, December 31, 1919

ASSETS.	CAPITAL, LIABILITIES, AND SURPLUS.
Fixed or Capital Assets.	Capital Stock.
Plant and Property. Schedule 1.	Preferred:
Investments. Schedule 2.	Authorized.
Treasury Stock at Par.	Less—Unissued.
Treasury Bonds at Par.	Issued and Outstanding.
Patents.	Common:
Trademarks.	Authorized.
Goodwill.	Less—Unissued.
Working and Trading Assets.	Issued and Outstanding.
Inventories, Schedule 3.	Capital Stock Subscribed.
Current Assets:	First Mort. 5% Bonds.
Cash. Schedule 4.	Authorized.
Securities. Schedule 5.	Less—Unissued.
Accounts Receivable.	Issued and Outstanding.
Accrued Interest on Bonds Owned.	Five-year 6% Notes Issued and Outstanding.
Dividends Declared on Stocks Owned.	Current Liabilities:
Drafts and Notes Receivable.	Taxes Accrued.
Interest Accrued on Drafts and Notes Receivable.	Payroll Accrued.
Due from Subscribers to Capital Stock.	Accounts Payable.
Total Current Assets.	Notes and Drafts Payable.
Sinking Fund for Bonds. Schedule 6.	Expenses Accrued.
Insurance Fund.	Interest Accrued on Notes and Drafts Payable.
Pension Fund.	Dividends Payable.
Deferred Assets. Schedule 7.	Interest Accrued on First Mort. Bonds.
	Interest Accrued on Five-Year Notes.
	Total Current Liabilities.
	Reserves. Schedule 7.
	Profit and Loss Surplus.
	Capital Surplus.
Total.....	Total.....
	Contingent Liabilities with particulars.

Schedules Supporting Balance Sheet.

1. Plant and property:
 - Land and buildings.
 - Additions to buildings.
 - Plant equipment.
 - Horses, wagons, and motors.
 - Furniture and fixtures.
2. Investments:
 - Securities owned: Names and amounts of stocks

and bonds with dividend and interest yield,
price paid and present market price.

3. Inventories:
 - Raw Materials.
 - Manufacturing department.
 - Finished goods, manufacturing.
 - Finished goods, trading.
 - Shipping department.
 - Coal, oil, and waste.
 - Stable and garage supplies.
 - Postage, stationery, &c.
4. Cash in hand and on deposit:
 - Cash in bank.
 - Impressed cash, and expense fund.
 - Freight deposit.
5. Securities:
 - See Schedule No. 2.
6. Sinking Fund:
 - See Schedule No. 2.
7. Deferred charges to expense:
 - Discount on bonds.
 - Legal expense deferred.
 - Organization expense.
 - Insurance prepaid.
 - Rent paid in advance.
 - Taxes paid in advance.
 - Advertising.
 - Advances for subsidiaries:
8. Reserves for:
 - Depreciation, Buildings, Equipment, etc.
 - “ Outside investments.
 - “ Subsidiary securities.
 - “ Treasury stock.
 - “ Treasury bonds.
 - “ Raw materials.
 - “ Current asset securities.
 - “ Accounts and notes receivable.
 - “ Sinking and other fund securities.
 - Extinguishment of assets.
 - Dividends.

A corporation must have well designed and executed accounting control in order that it be properly managed and proper report given to the security holders.

Since the worth of a security is in effect a reflection of the credit position of a corporation, the Statement Form of the Federal Reserve Bank of New York will be found highly suggestive. (Obtainable direct.) That this form is not complete will be seen in comparing with other bank forms. See *Wall, Bankers' Credit Manual*, 57-134.

2. *Certificates of Public Accountants.*

Collver, 71-74; *Tovey*—Balance Sheets, 64-71.

Uncertified report, whether on circular or in published corporation report, like an unsearched real estate title.

Class of work done by accountants varies greatly—sometimes done to suit corporation officials.

Acceptance of competitive bidding for audit work unwise policy.

Partial audit.

Accountants should in their certificate assume wide responsibility. Accountants assume no responsibility other than that stated in the certificate of audit. To the interest of investor to read the auditor's certificate concerning figures given in an offering of securities.

To show the necessity of knowing what the accountant's certificate assumes, a recent balance sheet had attached a certificate stating that a part of the company's inventories and accounts and bills payable standing against these inventories were not included in the statement. Another company charged huge losses against organization expenses, adding them to the assets. The bare balance sheets would not have disclosed the facts.

VIII

Analysis of Balance-Sheet Items. Debit

I.—*Capital Assets*

These assets, excluding investments, are often combined in one item: Plant and Equipment. The amount may simply be an arbitrary figure offsetting the amount of stocks and bonds on the credit side. Often largely "good will" or "water." Tangible and intangible assets should be separated.

Danger in issuing securities against overvalued and unserviceable plants, which cannot compete successfully or support interest or dividend-paying securities.

Depreciation, including obsolescence, must be provided for. General methods of accounting depreciation. Examples.

Collver, 81-89; *Hatfield*, 121-143; *Mead*, 190-198, 200-204; *Lough*, 422-426; *Gerstenberg*—Principles, 706-711; *Cole*, 95-115; *Wildman*, 236-250; *Wall*, Bankers' Credit Manual, 227-232; *Saliers*—Depreciation, 13-33, 39-72, 77-79, 121-188.

Depreciation should be provided for es-

pecially well on property bought in times of inflation.

Unless capital assets be well maintained and proper depreciation allowed for, it would follow that the maturity of long-term bonds might find these assets of little value.

Insurance: Fire. Is enough carried and the amount changed sufficiently often to cover adequately yet economically seasonal requirements? Mistake for most corporations to "Carry own insurance."

Insurance: Use and Occupancy. Insurance against loss of business until destroyed property can be replaced. Modification covers only actual losses and fixed charges during such a period.

Collver, 90-92.

2. *Permanent Investments*

Either investments made out of surplus earnings or securities of subsidiary or affiliated companies.

Separate schedules of all outside investments with prices paid and other particulars should be given. Analysis item by item necessary. Special reserve usually necessary.

Possibilities of concealment and fraud between books of a holding company and subsidiary almost unlimited.

Collver, 93-96.

Separate and consolidated accounts neces-

sary in case Permanent Investment account is important and consists principally of subsidiary securities.

Collver, 96; *Wildman*, 296-301.

For unusually frank report on permanent investments of an industrial, see *Gerstenberg*—Materials, 627-662.

3. *Treasury Stocks and Bonds.*

Collver, 97-98; *Wildman*, 116-117.

Treasury securities are presumed to have been issued for full value—can be disposed of as desired.

Unless actually worth par in the market, should have a reserve as offset to discount in value.

4. *Good Will.*

Collver, 99-102; *Lyon I*, 83-107; *Lough*, 179-189; *Cooper*, 184-252; *Hatfield*, 107-118 (Including: other immaterial assets).

See also X. Page 67.

Good-will account is a capitalization of the profit resulting from business secured and therefore logically to be expected in the future. However, a good-will account may be simply an arbitrary figure.

Usually is given separately if at all unless there is necessity for concealing the actual value of the account with which good will is included.

Firms having the largest bona-fide good will often do not capitalize it on the books at all.

Good-will account often arises in recapitalization of corporation with common stock representing good will.

Good will may simply be capitalization of harmony of previously opposed interests.

May represent advertising.

Usually considered an asset of diminishing value and should be reduced year to year by setting aside surplus earnings directly or by adding to the final profit and loss surplus.

For decisions in re Good-will see *Gerstenberg*—Materials, 1019-1021.

5. *Patents, Trademarks, and Brands.*

Collver, 103-107; *Jordan*, 181; *Cooper*, 118-148; *Wall*—Bankers' Credit Manual 231-232; *Lough*, 426.

May be legitimate accounts, but may be arbitrary amount of Good will or "Water."

Basic patents of the most value. Examples of especially valuable patents.

Patents many times do not protect against infringement—often are simply a license to engage in lengthy, expensive litigation.

Patents a wasting asset—must be written off during their life.

Patent may create valuable good will.

Trademarks and brands may have material and lasting value.

Patents, trademarks, and brands should be protected in foreign countries well in advance of active preparations to invade foreign markets.

6. *Working and Trading Assets.*

Collver, 109-113; *Gerstenberg*—Principles, 733-734; *Wildman*, 118-125.

Consist of inventory items of all kinds from postage stamps to finished goods: materials used in the conduct of the business, or manufacture of goods. Account is called "Working Assets" in case of purely manufacturing concern; "Trading Assets" in case of a mercantile corporation.

Working and Trading Assets should be separately stated, but are sometimes included among Current Assets (see following page). Working and Trading Assets cannot usually be turned in to cash immediately.

Correct inventory must be assured both as to quantity and value.

Prices should be at cost with a reserve created if prices decline from cost. Usually valued at "cost or market value, whichever is lower."

Prices should not be marked up on balance-sheet accounts if inventory values advance, but when bought at abnormally high prices, ample reserves should be provided.

Goods in process valuation.

Finished goods valuation.

Value of inventories in relation to their nearness to raw material form.

Relation of inventories to discounts.

Complications which may possibly arise in regard to holding companies and subsidiaries.

7. *Current Assets.*

Collver, 115-117; *Gerstenberrg*—Principles, 730-733; *Wildman*, 126-133.

Accounts should include only items which will soon become available in cash.

Each item, e.g., cash, should be given separately. Possibility of misstatement in item so apparently simple as "Cash and Cash Items." See *Cole*, 118.

Relative status of Accounts and Notes Receivable.

Drafts, Notes, or Temporary Investments.

Schedules of securities should be given and basis of valuation. Should be highly marketable. Preferable valuation is at cost with reserve for depreciation if any.

Interest accrued on obligations and dividends declared.

Holding company status in regard to Current Assets can be shown definitely only by having the accounts of the holding company and subsidiaries separately and also a consolidated balance sheet with inter-company accounts eliminated.

8. *Sinking, Insurance, and Other Special Funds.*

Collver, 119-121; *Lough*, 161-171.

Sinking funds are accumulations of capital: *specific assets*, set aside to meet or to anticipate obligations maturing in the future or to retire preferred stock. May be in cash or securities.

Possible danger if accumulated in cash in company's treasury.

If in cash, location and control should be known.

If in securities, a schedule should be given, with purchase price and present value—with offset reserve for depreciation if any.

Provision that sinking-fund payments be made to a trustee, which each year will use the payments in retiring securities by purchase or call at redemption price—the securities then to be destroyed. Purchased bonds sometimes “kept alive” and interest paid on them.

Method of the United States Steel Corporation.

Insurance Fund. Should be in cash or marketable securities. If latter, schedules, etc., should be provided for as with Sinking Fund assets. See also *Collver*, 90-91, re insurance.

Special Funds. These may be accumulated and set aside, e.g., invested in securities for some special purpose such as for the equal-

ization of dividends. Not usually a good policy. Dividend Fund seldom yields enough to make it worth while, and investments may depreciate. *Lough*, 475-477.

See IX, 8. Pages 62-63 in re Reserves. See *Wildman*, 184-192; *Lough*, 465-466, and *Saliers*—Depreciation, 49-59 in re relation of funds to reserves.

9. *Deferred Assets.*

Collver, 123-126, 155; *Gerstenberg*—Principles, 735-736; *Wildman*, 153-158.

Usually neither current nor capital assets. Part are largely "assets by courtesy."

Prepaid Insurance—how handled on books.

Organization, Legal, or Moving Expense to be written off as soon as possible. Such items may be very large—sometimes hidden under one more or less ambiguous term.

Unusual advertising often included among deferred assets.

Advances to subsidiaries for expansion should be among Deferred Assets.

Discounts on Securities sold should be considered a deferred "asset" and written off.

Consideration of prepaid items as Current Assets. *Collver*, 155.

IX

Analysis of Balance-Sheet Items. Credit

I. Bonds.

Collver, 127-136.

(A.) General Consideration.

In early days of combinations, bonds were issued not only to the amount of the properties but also for promoters' profits, making a fixed charge of expected economies.

Moreover, bonds were issued on the basis of expected earnings in years of greatest prosperity, later causing the loss of hundreds of millions of dollars.

Few large corporations have too large bond issues to-day. Both financiers and investors have learned much by experience.

If a business is one having a steady income, bonds can safely be issued as a means of "trading on the equity." Advantage to the stockholders of "trading on the equity."

See *Lyon I, 50-82.*

The maximum size of bond issues should be determined by what can be earned with a

liberal margin in depressed times, as the bondholders hold the "mortgage on the farm."

The solvency of a corporation depends upon the form of capitalization and not the amount. Stock can be issued to any amount and in time of poor earnings, holders simply be told to wait.

Industrials should borrow money sparingly as a general rule. Earnings often fluctuate widely, and in the case of insolvency the plants may be of little value because of changes in demand for many lines.

Expansion as far as possible should be financed through earnings, or stock issue, especially in times of prosperity, as plant assets are apt to prove only a burden in times of depression. The customary business depression cuts off about 50 per cent. of the average industrial's income available for interest. Net earnings for each of the past five years should be at least double the total interest charges of all fixed obligations. Further capital requirements could well be met from profits and increased capital stock. See *Jordan*, 109.

(B.) *Bond Provisions.*

Security underwriters have wisely insisted upon limitation to the size of issues and have written into the indentures provisions that serve to protect the corporation against over-

ambition in expansion and to protect directly the investor's funds.

Typical provisions are that:

The unincumbered quick assets of the company and subsidiaries shall at all times exceed the aggregate debt of the company and subsidiaries, "Including the outstanding bonds of this issue."

"That the liquid assets of the company must equal the aggregate debts, including outstanding bonds of this issue." In such cases quick or liquid assets usually include inventories.

Collver, 133-134; *Mead*, 71.

Proportion to assets. *Lough*, 143-145.

Sinking Funds are often required to meet or anticipate obligations.

See VIII, Page 48.

Usually the sinking fund provides for a certain amount to be set aside each year. A more flexible plan, and better adapted to corporations which may have rather widely fluctuating earnings, provides for a certain percentage of earnings available for dividends set aside.

Many bond issues have a redeemable or callable figure usually at a price above par—say at 105 or 110 in case of long-term issues, so that the outstanding obligations may be called in in case conditions make such action advisable.

Amortization. *Lyon*, I, 144-165.

(C). *Convertible Bonds.*

Collver, 144-145; *Gerstenberg*—*Materials*, 324; *Jordan*, 26-27, 301-302; *Annals*—*Moody*, 77-78.

A method of providing for the eventual replacement of the bonds by stocks, and often used at times when conditions are unfavorable to the issue of common stocks is the issuance of bonds convertible into stock—nearly always into common stock, but occasionally, as in the case of the Western Electric 7s, into preferred stock.

The convertible bond holds its price as a fixed obligation, and enjoys an increase in value if the stock advances above the conversion figure later on.

Example: convertible 6 per cent. bond purchased at 90 convertible into common stock at 75 while stock is selling at 60. To the purchaser of the convertible bond at 90 the stock has but to advance above 67.50 before the bond can be converted at a profit. The price paid for the bond in percentages is multiplied by the conversion price for the stock, i.e., $90 \times 75 = 67.50$. Since the investor pays a certain percentage for his bond, below or above par, the stock should sell at the same percentage of the conversion price to establish the profitable conversion point. As a matter of fact, the investor does not have to convert to obtain his profit, because as the stock advances, the bond also increases in

price, and the bond holder can simply sell his bond at a profit.

Prospective convertible bond holders should see, however, that the speculative possibility of the issue he is considering is not limited by a privilege of the company to retire the bonds at a figure close to the price he pays.

Example. For examples of convertible provisions of a bond see *Gerstenberg*—Materials, 322-323.

2. *Short-Term Notes.*

Collver, 134-136.

Obligations coming due within five years are usually called notes, whether or not secured. They are issued either to carry temporary needs, or to avoid going into the long-time bond market at an unfavorable time, planning in the latter case to refund at a more propitious season. Skill or good fortune must attend refunding, including long-term bonds approaching maturity, for they are in effect short-term notes, because when near maturing obligations actually mature, conditions for refunding may or may not be favorable. Example of unfortunate maturity. Good managers plan refunding far ahead and conservative corporations which have strong financial backing have seldom, if ever, defaulted through inability to secure funds.

Short-term notes nearly always have a

callable provision in order that the corporation may redeem the notes, or refund them at an advantageous time into long-term securities.

Many funded debt securities, usually short-term notes but sometimes including long-term obligations, are issued in serial form, i.e., a certain amount coming due annually. This may be a good plan, obviating the complications of a sinking fund or other special measures for redemption, but care must be taken that not too large an amount come due any one year, so that the arbitrary maturity may not be too large in a possible year of decreased profits, as serial maturities must in most cases be taken care of from earnings.

See *Mead*, 89-90.

3. *Preferred Stocks.*

Collver, 137-141.

Following a recognition that excessive bond issues were dangerous, a multitude of corporations were financed by selling cumulative preferred stocks and common, and no bonds. The preferred was supposed to represent the property value. Sometimes not even the preferred was covered by assets. Several large corporations succumbed because of paying unearned dividends on excessive amounts of preferred stocks, in order to give promise of dividends on the common. Such practices are seldom undertaken nowadays. The amounts of preferred are hedged in by special provisions.

The dividend on a preferred issue may depend upon the provisions of any bonds or notes outstanding, i.e., provisions of the senior securities may call for setting aside of a certain amount or proportion of earnings—or may provide for the maintenance of a certain fixed or determinable surplus. Dividends on the preferred stock might be passed in order that the requirements of the senior securities be provided for fully.

As a rule it will be found that the aggregate market value of common stocks junior to seasoned preferred issues is large, i.e., the market equity for the preferred is large. Perhaps, however, the common stock may sell very high and yet the preferred not rank high. The reason for this would be that the common would be highly speculative, and purchasers bought it with the idea of huge *potential* earnings, while, since only investors would buy the preferred, this issue would not be attractive, owing to the lack of *proved* earning power.

For special provisions, which safeguard and set standards for preferred issues, see V (Provisions of Preferred Stocks), Pages 8-23.

4. *Common Stock.*

(A.) *Industrial Common Stocks Are Seldom to Be Considered as Investment Securities.* Earnings and dividends usually fluctuate widely. In some cases, however, after years

of conservative policy, regular dividends have become fully as safe as on a good part of the preferred issues. Usually investment common stocks yield moderately on the market price since their speculative possibilities in giving out extra dividends, rights, or increasing the dividend are reflected in the quotations. On the other hand, high-grade investment preferred stocks, long and short term bonds reflect the value of money—interest rates.

The dividend position of a common stock may depend upon the provisions of the preferred issue or issues, and upon the provisions of any bonds or notes outstanding, i.e., provisions of the senior securities may call for setting aside of a certain amount or proportion of earnings—or may provide for the maintenance of a certain fixed or determinable surplus. Dividends on the common stock might be passed for a time in order that the requirements of the senior securities be provided for fully.

For different forms of common stocks see II, 2 Pages 6-7.

For legality of issue of stock see *Hatfield*, 144-183.

(B.) *Changing Capitalization Form. Rights.* *Collver*, 143.

As corporations are able, they usually retire the bond issues through either call at the redeemable figure or through purchase in

the open market. Such operation has several benefits—reduces the interest on capital requirements of the company—maintains the market value of the bonds—makes even stronger the position of the bonds not yet retired. Reduces the inconvenience of having a bond issue to refund at maturity. Example.

Financing through issue of common stocks.

Collver, 144. *Lyon* II; 15-34.

When common stocks with established earnings are selling well above par in a favorable general market, corporations often prefer to issue common stock to the holders of that already outstanding than to issue other forms of capitalization as payments on common stocks are optional. If the market price is low or general market conditions especially unfavorable the issue of new stock might not be successful and injure the credit of the company. It is now customary to have new stock offerings underwritten by strong investment bankers, who usually syndicate the liability assumed.

For mathematics of rights see *Jordan*, 21-22.

Rights are also given common stockholders in many instances to acquire preferred stocks and bonds at favorable figures. Example: right to subscribe to Standard Oil of New Jersey Preferred at par in 1920.

For form of right to subscribe to preferred stock see *Gerstenberg*—Materials, 1017-1018.

5. *Current Liabilities.*

Collver, 147-151; *Kniffin*, 454-457; 460.

Include unfunded corporate obligations which will soon be payable. *Technically* do not include bonds or notes soon maturing—actually do include such items. Include actually items such as taxes accrued, but not paid at the date the balance sheet is made up. Wages Accrued, Interest Accrued on Notes and Drafts Payable, Interest Accrued on Bonds and Notes Payable, Dividends declared but not paid, and Expenses Accrued should be given separately and under the Current Liability head.

Accounts and Notes Payable should be given separately. Accounts payable represent supplies, while Notes Payable, including Bills and Drafts, may represent accounts that the corporation could not meet promptly or a multitude of other purposes that require special explanation. Seasonal businesses are generally financed by notes discounted at banks.

Notes Payable, known as commercial paper have normally a ready sale in the market. Possibility of over-extension through increase in amount of commercial paper. Registration of commercial paper. See also *Gerstenberg*—Materials, 907-908.

Advantage in analyzing if bank loans are separated from ordinary trade obligations. If assets are pledged for loans, particulars should be given. See *Tovey*—Balance Sheets, 36-38.

Contingent Liabilities. This item is not an absolute liability and should appear in case contingent liability exists, as a footnote to the balance sheet. May be an important and even dangerous item.

6. *Working Capital.*

Collver, 153-156.

Working Capital or Net Current Assets are the net free quick assets of a corporation. Not usually given on a balance sheet. Found by subtracting current liabilities from current assets.

Most industrials require a large amount, dependent upon the nature of the enterprise. Certain lines of industrials require little working capital.

Technically, Net Current Assets do not include any Inventory Account, but general practice is to include them. Example of usual Current Assets, Current Liabilities, and Net Working Capital. Possibility that current liability items be concealed among long-term obligations.

Net Working Capital should normally increase. Certainly it should not be decreased except for good cause.

Technical Net Quick Assets should be worked out for several years back from balance sheets, omitting Inventories. The Net Working Capital, including Inventories, may show a splendid increase from year to year,

but if this increase is accounted for in a rapid increase in inventories, the situation may be dangerous, owing to a possibility of loss in the value of the goods.

Floating Debt: an excess of current liabilities over current assets. Usually a dangerous condition, especially if inventory accounts have been considered among current assets.

Working Capital position is the first test of an industrial's condition made by bankers, investment dealers, and careful investors.

See *Jordan*, 351; *Lough*, 361-363; *Gerstenberg*—Principles, 127-132.

Comparison, however, must be made of balance sheets of the same seasons of the year, as most industrials are seasonal in working capital requirements.

Amount of working capital required determined by:

- a. Size of corporation.
- b. Variety of products.
- c. Whether company is expanding rapidly.
- d. Whether it takes a long or short time for goods to be manufactured.
- e. The extent the business is seasonal, seasonal business requiring large amount.
- f. The quickness of turnover, slow turnovers requiring large amount.

- g. Terms of credit extended—the longer the terms the more capital required.
- h. Longer terms company can obtain in purchasing the less capital required.
- i. Difficulty in securing raw materials—if great, must anticipate requirements and pay for much stock far in advance.

Suggested method of estimating initial working capital requirements. See *Lough*, 380-414, 502-507.

7. *Reserves.*

Collver, 157-158. *Saliers*—Financial Statements, 57, 62-78.

Wildman, 174-183; *Lough*, 426-427.

Necessity of adequate reserve already taken up in consideration of Fixed or Capital Assets. VIII. 1. Pages 42-43.

Permanent Investments VIII. 2. Pages; 43-44.

Working and Trading Assets VIII. 6. Pages 46-47; and Current Assets VIII. 7. Page 47.

Reserves, besides those for depreciation of buildings, equipment, securities, materials, and receivables, may be provided for special purposes, e.g., relining blast furnaces, and for the exhaustion of assets such as coal or ore, and even for setting aside profits for sinking funds.

Reserves are not funds—*reserves are not*

represented in cash, securities, or other definite assets. They are amounts taken from profits and placed on the liability side. *The amount of the reserves is represented in the total of the assets.* The amount credited to the reserves cuts down the amount of profits which can be distributed as dividends.

Yet a reserve may specifically be created to provide for regular dividends. Little is gained by such provision, since the entire Profit and Loss Surplus can be considered as a reserve for dividends. See IX. 9. Pages 63-65. A company may have any amount of reserves set aside for dividends, yet it must be remembered that the immediate source of dividends is net current assets—particularly *cash*.

Secret Reserves. *Gerstenberg*—Principles, 751-752; *Hatfield*, 254-255; *Lough*, 479-481.

Secret Reserves are really an understatement of the final surplus—caused by (a) Providing too liberally for depreciation; (b) Excessive provision for bad debts; (c) Charging capital items to expense accounts; (d) Omitting or undervaluing assets. Secret reserves are of course a source of strength, but deceive stockholders.

See also Sinking, Insurance, and Special Funds. VIII. 8. Pages 48-49.

8. *Surplus.*

Lough, 466-475; *Gerstenberg*—Principles, 161-164; *Saliers*—Financial Statements, 79-87.

Quoting *Collver*, 159-160:

“Profit and Loss Surplus is not a tangible account any more than the reserves. Though originating as undivided profits, the Profit and Loss Surplus will be found to be simply the remainder after subtracting the liabilities and the capital stock from the assets. It evidences the amounts of assets above liabilities belonging to the stockholders aside from and added to the par value of the stock.

“The surplus is real only if the assets are real, and if the liabilities are correctly stated. If a corporation has \$1,000,000 worthless ‘Good will’ among its assets and \$500,000 nominal Profit and Loss Surplus, no actual Surplus exists, but instead a true deficit of \$500,000.

“Even when the book Surplus is entirely bona fide, it is seldom available in cash assets. The Profit and Loss Surplus is simply an account of profits not used for dividends, but these profits usually have been used in the corporation’s business. The surplus may be represented in materials, in machinery, in plant, or in part of any number of assets. It is quite possible for a corporation to have a splendid surplus in fixed assets, and yet be hard pressed for ready cash. Hence, while surplus is decreased by the cash expended in dividends, yet ‘paying dividends out of surplus’ is scarcely a statement of fact. Cash dividends are of course payable only in cash.

Financial strength usually depends more upon the amount of free working capital assets than upon the amount of nominal surplus.

“Capital Surplus is an account similar to Profit and Loss Surplus, but created in quite a different manner. Suppose 10,000 shares of stock are sold at 150 or \$1,000,000 par value sold for \$1,500,000. The difference of \$500,000 is not to be credited to Profit and Loss Surplus because it is not considered an earned profit account, but a separate Capital Surplus account.

“Many Balance Sheets do not show Profit and Loss Surplus separately from Capital Surplus, but show the mixed account as simply ‘Surplus.’ Part of the Surplus item of one of the largest industrials originated from an exchange of securities. Second preferred 6 per cent. stock was exchanged for first preferred 8 per cent. stock at four shares of the 6 per cent. for three of the 8 per cent. stock. The actual dividend requirement remained the same. However, the capital stock amount was reduced and the company exhibited the difference as an addition to the Surplus. No deception was intended, and the transaction was explained in the annual reports, but an examination of the balance sheet alone leads many people to believe the large ‘Surplus’ represents only profits conserved from the business.”

X

Book Value

Collver, 161-163. *Jordan*, 119-121. *Tovey*—Balance Sheets, 61-63. See also *Collver*, 89, 90.

Book Value is the theoretical asset value of stock derived from a balance sheet and with no direct consideration of earning power.

Method of obtaining book value of common stock:

Subtract the liabilities, including reserves and of course all fixed obligations, and the preferred stock from the assets. Divide the remainder by the number of common shares outstanding.

Short method, and proof of the foregoing methods if the common stock has a par value: Add the total common stock par value to the surplus. Divide by the total number of shares of common. This rule holds even in case of no par value stock. No par value stock may separately be credited with value or may be valued with surplus in one account.

Method of obtaining book value of preferred stock:

Subtract the liabilities, including all fixed obligations, from the assets. Divide the remainder by the number of preferred shares outstanding.

Short method and proof of the foregoing: Add the total amount of the common par value and the total amount of the preferred to the surplus. Divide by the total number of shares of preferred outstanding.

Calculation of book value, like that of Surplus, is exact to the extent that the accounts on the Balance Sheet are accurate. If there is more "Good-will" than there is remainder after subtracting liabilities and preferred stocks from the assets, the common will have no tangible book value at all, and if there is a preferred issue the preferred may not be represented by tangible book value to the extent of 100 per cent. par. Therefore, analysts strike out from the assets any dubious accounts before attempting to work out the book value. It is quite the usual procedure to make the Good-will item large enough so that the common stock will appear to be covered entirely by assets.

The book value is at best usually only of real service if the assets are of a salable nature or backed by good earning power. For instance, the preferred stock of one large company—later reorganized and now prosperous—had actual assets of more than a hundred dollars a share back of it while the stock sold for the nominal cost of brokerage. The assets could not be

sold to advantage and the company was losing money.

As indicating how differences in valuing property affect the book value, consider some of the steel corporations which have large holdings of iron ore lands. Great difference of opinion exists in regard to the value of this ore, even of that which is "proven." The book value of several steel companies could be multiplied several times simply by placing a higher but apparently reasonable value on the ore properties.

However, any such procedure would not add to the market value of the stocks. The prices of the common stocks are mostly based upon earnings, past, present, and *prospective*, and dividends past, present, and *prospective*. Value of assets, particularly "natural resource assets" such as ore and lumber, are usually of value to an industrial only as these assets can be turned into finished product, the finished product sold, and *profits* realized.

To take a skeletonized balance sheet:

ASSETS		CAPITAL, LIABILITIES, AND SURPLUS	
Fixed Assets.....	\$11,000,000	Capital Stock	
Working Assets.....	13,000,000	*Common 50,000 sh.	5,000,000
Current Assets.....	15,000,000	Preferred Par \$100	6,000,000
Sinking and other		First 6% bonds.....	10,000,000
funds.....	2,000,000	Current Liabilities...	14,000,000
	<u>\$41,000,000</u>	Reserves.....	1,000,000
		Surplus.....	5,000,000
			<u>\$41,000,000</u>

*Par value—Declared value in the case of no par value stock.

To find the book value of the common stock subtract the current liabilities, plus amount of first 6 per cent. bonds, plus preferred stock, plus reserves, which amount to \$31,000,000—from the \$41,000,000 assets. Divide the remainder, which is \$10,000,000, by the number of common shares, i.e., by 50,000, gives \$200 a share as the book value of the common stock.

Short method and proof of the foregoing:

Add the \$5,000,000 account of common stock to the \$5,000,000 surplus and divide the remainder by 50,000, the number of common shares—giving \$200 a share.

To find the book value of the preferred stock, subtract the liabilities, including current and fixed, plus reserves, which amount to \$25,000,000—from \$41,000,000 assets. Divide the remainder, which is \$16,000,000, by the number of shares of preferred outstanding or 60,000, give \$266.67 as the book value of the preferred stock.

Short method and proof of the foregoing:

Add the total amount of the common par value, i.e., \$5,000,000, the amount of the preferred, \$6,000,000, to the \$5,000,000 surplus. Divide the amount \$16,000,000 by 60,000, the number of preferred shares, and we have \$266.67.

XI

Comparison of Balance Sheets Different Years

Gerstenberg—Principles, 741-742; *Cole*, 110. 127-132.

Collver, 75; *Tovey*—Balance Sheets, 47-58.

Wall, Bankers' Credit Manual, 117-134.

Wood, 28. 39. 342. (Shows Balance Sheets and Profit and Loss figures combined.)

See also XVI. Pages 97-98.

Many companies present Balance Sheets only—no Income Accounts. Investors have attempted to figure the actual earnings by comparison of the latest with prior Balance Sheets, taking into consideration the dividends paid during the year, i.e., increase in surplus plus dividends equals earnings. Without detailed earning figures to check up, the asset accounts can so easily be juggled through excess valuation—in order to make a good showing in the surplus accounts, that the comparison may be of little value.

Comparison of Balance Sheets should show the change in the amounts of current assets and

liabilities, and any change in the relation of the two.

A large increase in inventories, accompanied by a corresponding increase of notes payable and a shrinking in cash resources, would indicate a situation requiring explanation in order not to appear dangerous with the prospect of possible lower prices in commodities in view. In fact, a large increase in inventories, no matter how balanced, on the financial statement, is often a clear indication of dangerous over-expansion.

It should be remembered that an abnormally large inventory, however, even during periods of inflation, may not be indicative of dangerous condition. Many companies do not carry large inventories awaiting orders, but purchase raw materials only after bona-fide orders are received with terms cash upon delivery.

Other changes, for example the growth of investments, will account for the increase in the surplus shown, while decrease in intangible accounts, such as good will, indicate a general strengthening of the corporation's position not entirely indicated by an increase in surplus.

Comparison of Balance Sheets before and some time after bond or note financing should indicate how the funds have been used. Sometimes important in checking up the "purpose" of the capitalization. It will easily be understood that refunding finance, i.e., issuance of new bonds or notes to take the place of maturing is-

sues, usually gives rise to fewer questions as to whether the corporation can support the issues than in the case of issuance of entirely new securities with which to engage in a program of wide expansion, with the speculative chances involved. Such speculation is minimized when the new securities are issued with which to pay for a purchased, long-established competing or allied business.

See *Collver*, 136.

For comparison of Balance Sheets for different years and with different companies see *Cole*, 132-138.

XII

Income Accounts

I. *Consistent Form Necessary.*

Earnings are the final measure of progress and value. Great assets are normally of little avail unless capable of profitable use. See X, Pages 67-68.

The Income Account shows the changes which have occurred during the period affecting the Balance Sheet—gives account of the conduct of the business with losses and gains, together with accounting of the disposal of net results.

Because of lack of standardization in the make-up of Income Accounts and because of the possibilities of misrepresentation in the make-up of income figures, particularly in those of the "short and snappy" variety, skepticism must accompany the examination.

Accountants differ as to the form of the simplest Income Account—even as to the name of the account itself and as to the names of items. . . . Nevertheless, the Income

Account is usually easier to understand than the Balance Sheet, and if the methods of the company in making up statements are fair, the Income Account may be analyzed.

The best assurance that the method of accounting is legitimate and that the basis of making up the figures has not changed from one year to another without due warning is the certification of a reliable firm of public accountants. However, even a properly certified Income Account is of limited use in analysis if it lacks in definiteness and detail. For example, one of the largest industrials presents the amount of "Net Profits" carried to surplus after all sorts of unspecified deductions for "Federal Taxes, Rentals, Renewals, Depreciation, and Contingencies." Apparently the partner-stockholders are not to be trusted overmuch with information.

As showing the varied methods of accounting procedure, items such as insurance, rent, and taxes may one year be charged as general expenses, and next year among fixed charges. Since it is necessary to examine and compare the Income Accounts of a corporation for several years in order intelligently to judge its earning power, it follows that when accounts are given in detail, yet have inconsistencies in the method of handling the main items, that the Income Accounts are not comparable till adjusted.

See *Collver*, 165-168.

2. *Holding Company Figures.*

Collver, 168-169; *Gerstenberg*—Principles, 752-753; *Lyon*, II, 196-208.

In the case of a holding company, analysis is apt to be futile unless the results of subsidiaries and holding company be combined into a consolidated Income Account. Otherwise, supposing that only dividends from subsidiaries are reported in the holding company's report, large losses of certain subsidiaries might be concealed. Conversely, large profits may be hidden through the accretion by certain subsidiaries of undivided profits.

A fair basis of analysis is present only provided that detailed consolidated Income Account and detailed Income Accounts of each subsidiary are available.

3. *"Standard" Corporation Form.*

Below is given a condensed comparative Income Account (but more detailed than usually found in published reports). This is as published by the Federal Reserve Board from forms prepared for the Federal Trade Commission by the American Institute of Accountants. See Page 76. This form has been adopted by large financial interests as satisfactory for most industrials, but can be used in some lines only by adaptation.

FORM FOR PROFIT AND LOSS ACCOUNT

Comparative statement of profit and loss for three years ending. . . 19

	Year ending—		
	19—	19—	19—
Gross sales.	\$.....	\$.....	\$.....
Less outward freight, allowances, and re- turns.
Net sales.
Inventory beginning of year.
Purchases, net.
Less inventory end of year.
Cost of sales.
Gross profit on sales.
Selling expenses (itemized to correspond with ledger accounts kept).
Total selling expense.
General expenses (itemized to correspond with ledger accounts kept).
Total general expense.
Administrative expenses (itemized to corres- pond with ledger accounts kept).
Total administrative expense.
Total expenses.
Net profit on sales.
Other income:			
Income from investments.
Interest on notes receivable, etc.
Gross income.
Deductions from income:			
Interest on bonded debt.
Interest on notes payable.
Total deductions.
Net income—profit and loss.
Add special credits to profit and loss.
Deduct special charges to profit and loss.
Profit and loss for period.
Surplus beginning of period.
Dividends paid.
Surplus ending of period.

For more detailed Income Accounts see *Wild-
man*, 307-310.

XIII

Analysis of Income Accounts

1. *Gross Sales.*

Collver, 171-173; *Lough*, 418-421.

Gross Earnings is given instead in some cases, e.g., corporation dependent upon licensing of patents. Item, whether gross sales or earnings, should designate total receipts from regular corporation operation. Should include no earnings not actually realized—no “estimated profits”—no proceeds from fixed assets sold.

Comparison of Gross Sales for different years should show whether business improving, whether business consistent or subject to violent fluctuations. Should be remembered that in years of rising prices expansion in Gross Sales may be more representative of inflation in prices than in quantity of sold output.

In connection with other figures Gross Sales brings out the profits per dollar of Gross Sales, which is highly important, especially in comparison from year to year.

2. *Gross and Net Profit.*

Collver, 173-178; *Lough*, 421-422.

Net Sales, i.e., the gross less "outward freight, allowances and returns" is not often given, though when available it is a valuable figure. In the case of a holding company report, the net sales should exclude intra-company transactions which are often highly important.

Cost of Sales: seldom available unfortunately from reports. When given or obtainable by deduction from the figures, subtraction of Cost of Sales from Gross Sales gives Gross Profits on Sales. In a manufacturing corporation the factory cost of production takes the place of "Purchases, Net," in the Income Account. See XII. Page 76.

Ratio of Gross Profits to Net Sales should be calculated and compared, one year with another, but with allowances for general conditions and results of similar corporations. Except in times of inflation competition will tend to decrease the Ratio of Gross Profits to Net Sales in spite of the best management.

Owing to lack of standardization in the making up of accounts, and the frequent inclusion in factory costs of important improvements and extensions, a decrease in Ratio of Gross Profits to Net Sales may indicate increase conservatism of management.

If the decrease is consistent and caused by

increased cost of labor, power, etc., the decrease is to be considered unfavorably. Since particulars are usually unavailable, unless it can be proved that maintenance and depreciation charges have been neglected, an increasing Ratio of Gross Profits to Net Sales is normally to be considered as evidencing increasingly profitable operations, and a decreasing ratio as at least dubious.

Selling, General, and Administrative Expenses are seldom found in published reports. Items which make up these separate accounts. Many corporations reporting large expenses are really cutting down taxable profits through abnormally large advertising campaigns.

Gross Profits on Sales, less Selling, General and Administrative Expense, gives Net Profits, sometimes called Net Profits on Sales. Ratio of Net Profits to Net Sales for different years should be figured and compared, but with caution. Of course, a company having a rapid turnover such as a packing company cannot be expected to have as large a Ratio of Net Profits to Net Sales as in the case of a bridge corporation which may do very well in turning over its capital once a year.

When Gross Sales are given Net Profits are usually also published. The ratio of the latter to the former is the most valuable that can be worked out from the Income Account. It is reached after all the primary cost and expense items are supposed to have been

charged off, no matter how. Too often comparison is difficult owing to the tendency to skimp renewals, depreciation, etc., in poor years, relying on especially good years in which to make up deficiencies. Of course, renewals, depreciation, etc., should be considered as part of cost in all years. Without detailed accounts or knowledge as to the corporation management's procedure, it may be difficult to tell which policy has been adopted.

3. *Other Income.*

Collver, 179-180; *Wildman*, 225-230.

Special profits or losses should be shown separately, and placed in Other Income Account in case of profit, or deducted from Net Earnings in case of loss. For example, from 1914-1918 many industrials organized special departments to carry on business strange to the organizations: war materials of various sorts. Unless results from such efforts are separated, comparison with results in other years would be difficult.

Usual source of Other Income is Interest and Dividends from securities owned. If amount is large it is highly important to give special attention to the securities held. In some instances corporations have issued their own securities in order to pay for those held in the treasury. Discontinuance of the income might be disastrous to the holder.

Quite usual for corporations to have interest in others which have complementary work.

Example. Example of large corporation which has large general investments purchased from profits.

Interest on bank balances and rentals are also Other Income.

Proceeds of capital assets, often included in Other Income. Should not be. Should include only the profit on any such transaction—any loss to be deducted from Net Earnings—leaving Balance Sheet and Income Account in natural accord. Still better to include such unusual source of income with Profit and Loss, keeping even the Other Income Accounts for different years as nearly comparable as possible.

Special profits should not include arbitrary increases in assets or “estimated profits” from incomplete operations.

4. *Total or Gross Income.*

Collver, 181; *Wildman*, 231-234.

Account obtained by adding Other Income to Net Profits. Accountants differ greatly as to the items which should be deducted from Total or Gross Income and which should be taken into consideration before this account is reached. As giving the view of one authority:

“The Other Income added to the Net Profits gives the Total or Gross Income.

From the Total Income are deducted Federal taxes, Interest on bank loans and bonds, Amortization of bond discount, and Cash Discounts on sales. These expenditures are subtracted from Total Income because they are considered expenses of capital, the expense of obtaining, using, and protecting capital, set up separately in order to show what the Total Income would be if there were no expenses in connection with capital. Interest actually belongs among the expenses of capital, of course, but is like Federal taxes usually separated in published reports for convenience in analysis."

5. *Interest.*

Collver, 183.

The Income Account should show separately interest paid on funded obligations and interest on bank loans, notes, and accounts payable. Indication that the company has important accounts payable past due if the Balance Sheet shows a small amount of loans—from banks—with an Income Account showing a relatively large amount paid for interest on short-time loans.

If interest rates have been fairly normal during the period and the credit of the company good, the amount of unfunded liabilities requiring interest can many times be calculated roughly, even though the amounts paid are not stated separately.

“Suppose the total interest paid is \$100,000 and the Balance Sheet shows \$500,000 5 per cent. bonds and \$500,000 6 per cent. notes, the funded debt would require \$25,000 plus \$30,000 or \$55,000 showing \$45,000 applied to unfunded debts. If fair interest rates were about 5 per cent., the Balance Sheet would probably include twenty times the interest charges, or \$900,000, of unfunded interest-bearing loans.”

6. *Profit and Loss Surplus.*

Collver, 185, 186; *Wildman*, 276-279.

As shown by the Income Account XII-3, on Page 76, the remainder after interest charges is Net Income. Then should come any special additions or deductions. Additions will be such as profits on plant or other capital assets, such as securities sold. Deductions will be amounts written off in reducing such accounts as Good will and Patents, Depreciation, Provision for Doubtful Accounts, and Discount on Bonds Written Off.

However, most corporations bring in special additions and deductions before interest is deducted.

Since dividends are, for any period, legally payable from earnings accrued since the organization of a company, it is technically correct to add the Surplus at Beginning of Period directly to the “Profit and Loss for Period” as shown on Page 76. . . , then to

deduct dividends, preferred dividends first, and leaving Surplus Ending of Period.

Most corporations show the Profit and Loss for Period—usually called Net Profits—deduct dividends, and add the remainder to the Surplus Beginning of Period. As to policy in declaring dividends see V. 2D. Page 30.

7. *Margin of Safety.*

Collver, 187-188.

“The Margin of Safety of Bonds is the Proportion of Net Income left after paying all fixed charges. A company which earns \$1,000,000 and has \$200,000 fixed charges, leaving \$800,000, or 80 per cent. Margin of Safety above fixed charges should be in better condition than if it had the same earnings and \$800,000 fixed charges, or a Margin of Safety of 20 per cent.

“The Margin of Safety over preferred stock may easily be reckoned by including after Profit and Loss entries, if any, the required dividends on the stock with the fixed charges before figuring the percentage. The Margin of Safety over the common stock may be computed by including its dividend return with the fixed charges and the preferred dividend returns. Suppose with \$1,000,000 earnings, fixed charges are \$200,000, preferred dividends \$200,000, and common dividends \$200,000. The fixed charges and all dividends are \$600,000, and the remainder, \$400,000, is 40

per cent., which is the Margin of Safety over the common stock disbursements.

“The strength of a corporation may fairly be tested by the Margin of Safety, checking up other conclusions. If the Margin of Safety over the different classes of securities is increasing, other things being equal, the corporation’s bonds and stocks may be considered as growing safer and stronger.”

8. *Average Profits.*

Collver, 188.

The “Average Profits” are many times given in security circulars in place of figures for separate years, simply because, unfortunately, investors wish generalities and do not welcome “statistics.” Deception may lie in “average profits” which may show a good figure, entirely adequate for a proposed new bond or preferred stock issue, in the face of dangerously decreasing or fluctuating earnings, but the investor has himself to thank that complete figures are often not given. Many times a good reason exists for a sharp decline, such as a flood or other local disaster, or a sympathetic strike. The conservative, discriminating investor will find the record of several consecutive years, even when containing a reasonably explained lean period, more attractive than the uncertainties of “Average Profits” which may be helpful, however, if conditions have been fairly normal throughout the years averaged.

XIV

Form and Amount of Capitalization

The outstanding lesson of twenty years' experience in industrial finance in this country is that the *style* or *form* of capitalization is of paramount importance. See IX. 1. Pages 50-51.

1. *Relation to Physical Value.*

See Outline of Corporation Finance and Investment, Pages 27-31. Adjusting Capitalization to Assets. *Lough*, 189-191.

2. *Relation to Earnings and Gross Sales.*

Lough, 179-189, 221-223, 513-514. *Lyon*, I, 83-107.

Corporations are usually capitalized upon earning power, present or prospective, though bonds certainly, and nearly always, preferred stock, represent tangible assets.

From *Lough*, 513-514: "Industrials frequently show a total capitalization equal to their gross earnings. This relation may

easily exist wherever the percentage of profit on sales is about equivalent to the percentage of profit expected in that industry Companies which do a large business on a small margin, commission houses, retail stores, manufacturers of staples, and the like, will customarily have a capitalization much smaller than gross sales."

For specific comparison of several important electric manufacturing companies see *Lough*, 515-518.

It is a fallacy to issue bonds against expected earnings, or in the case of a holding company, upon the aggregate earnings of the constituent companies prior to their combination, as the results of the amalgamation may be disappointing. See *Dewing*, 547.

Borrowing limited by liability of net earnings to fluctuate. See IX. 1. Pages 50-51. See also *Lyon* I, 54.

In case of a holding company issuing securities, the investor should go back of the purported earnings available for interest or preferred dividend charges. The amount available for interest or dividend charges may be almost entirely from *dividends received from operating* subsidiaries. In a year of declining business the operating companies which, we will assume, have large interest requirements, may suffer a loss in net earnings available for their fixed charges. This loss, while very small in comparison to the

total business of the operating companies, may be just enough to wipe out all earnings which the holding company depends upon in order to take care of the holding company's interest or preferred dividend requirements.

This point simply emphasizes the necessity of having complete information available in regard to both holding company and subsidiary affairs. The least that the investor should require would be consolidated Balance Sheets and Income Accounts. The latter would show the amount available against *all* interest requirements. See XII. 2. Page 75. See *Lyon*, II, 196-208.

Circulars usually show that earnings available for interest amount to so many times the amount required. The investor should see that the amount required includes *all* the fixed liabilities and not simply the requirements on the issue offered. A Note issue may show requirements earned ten times—taking the amount available *after* paying all other bonds. Applying the amount available for fixed charges against all fixed obligations, including the offered issue, may show requirements earned but twice—using the figures taken from the same Income Account. Perfectly proper to show the earnings and requirements *both* ways.

XV

Special Financial Standards

Since industrial activity has been so varied, and standards of accounting used by industrial corporations almost as varied, no such accurate standards of operation and finance are possible as in the railroad field. However, a most helpful beginning has been made.

Wall—Financial Statements. See also *Wall*—Bankers' Credit Manual, 132-133, 137-164.

1. "*The Two-for-one Rule*," i.e., that a financial statement must show at least two dollars of current assets (including inventories) for every dollar of current liability in order to show a good credit proportion. "Dressing" a financial statement to make a good showing.

Supplementary ratios as follows:

(A) *Comparison from year to year: Ratio Accounts and Notes Receivable to Merchandise.*

If percentage increases we should expect to find an increasing percentage of profits included in current assets, and therefore an increase in the ratio of current assets to current liabilities.

(B) *Ratio Net Sales to Accounts and Notes Receivable.* Shows the liquidity of the receivables and is a most important qualitative consideration in judging the rapidity of collection.

(C) *Ratio Sales to Merchandise.* Shows the liquidity of merchandise.

(D) *Ratio of Net Worth to Fixed Assets.* If a falling one denotes expansion in plant perhaps more rapid than advisable. See note after (F).

(E) *Ratio of Sales to Net Worth.* High ratio may in certain lines denote under-capitalization and a feverish condition. Low rates may indicate dry rot or unprofitable use of invested funds. See note after (F).

(F) *Ratio of Total Debt to Net Worth.* Shows the proportion of the total capital used supplied by creditors and by the owners of the business.

NOTE: Net Worth is the Book Value of *all* stocks, preferred and common, of a corporation, and is obtained simply by subtracting the liabilities, including reserves and all fixed obligations, of course, from the total assets. See X, Page 66.

Necessity of understanding different proportions that normally exist in different lines of business, and between companies operating in different parts of the country.

Wall—Credit Barometrics. Includes thirty tables of statistics including actual ratios

taken from many establishments in industrial lines. See also *Kniffin*, 444-445 in re the "Two-to-One Ratio."

(G) *Ratio of Sales to Fixed Assets*. Shows the dollars of net sales for every dollar invested in plant and non-liquid assets. This ratio may be used in connection with Ratio of Net Worth to Fixed Assets (D). If worth to fixed assets falls and sales to fixed assets also be a falling ratio, shows plant is enlarging faster than net worth and at the same time its sales productivity is not keeping pace with increase in size.

In considering ratios allowance must be made for different conditions in general business. Time of year may be important. Usually not fair to compare a January with a July Statement.

2. *Other Financial Standards.*

Lough, 500-524.

(A) *Relation of Working Capital to Total Capital*, i.e., total par value of stocks and bonds.

"With almost no exceptions, companies which are competitive or in the same general class of business have approximately the same relations of working to total capital." Companies which have to carry large inventories or materials, goods in process and finished goods, and those which find it necessary to sell on an instalment or long-term basis,

require a large actual and relative amount of working capital. Figures from prominent corporations given.

(B) *Cash and Cash Resources.* Relation of Cash and Cash Resources (Resources immediately convertible into cash, principally securities held for sale) to total capital, to gross volume of business, and to current liabilities.

Financial corporations have practically all their capital in cash and cash resources. Proportion to demand liabilities is from 15 to 25 per cent. Purely industrial corporations have from 1 to 16 per cent. of total capital in cash. Seldom runs above 7 or 8 per cent., which is above average.

Canadian and most foreign companies depend more upon their banks than do industrials in this country, and carry proportionately little cash.

Most industrials in this country have on hand at the end of the fiscal year 3 to 6 per cent. of the amount of gross sales in cash. If a company pays bills promptly and does not overborrow, current liabilities should not exceed 20 to 30 per cent. of annual sales—referring to company making articles which sell in steady volume. Follows that cash and cash resources should be about 12 to 25 per cent. of current liabilities, which is about average.

(C) *Turnover.* Depends upon nature of

company. Commission selling house carrying no stock ordinarily has a very large turnover—to 1,000 per cent. of working assets or higher. Large department store turns over entire stock about twice a year. Many grocery stores have a turnover once a month. In manufacturing companies, depends upon nature of manufacture. Should be remembered that working assets vary considerably from season to season, and variation in this amount makes a large difference in figuring turnover.

See also *Lough*, 384-388; *Kniffen*, 420-421, 448-449, 458.

Gerstenberg—Principles, 748-49.

(D) *Operating Ratio*. (A term not accepted generally by accountants in regard to industrial activity, but corresponding roughly to the railroad term—C.C.) Is “percentage of total expense of running the business, including manufacturing, selling, and administration, to the gross sales. It is clear that the difference between 100 per cent., which represents gross sales and the operating ratio, is the percentage of gross profit to sales.”

See also XIII. 2. Page 78.

From *Lough*, 511-513: “The lower this percentage of gross profit, or, in other words, the higher the operating ratio, the more unstable, other things being equal, is the business as a money maker: for a high operating ratio means that even a slight variation in

expenses may be sufficient to transform a profit into a loss. On the other hand, a phenominally low operating ratio indicates a business which is earning excessive profits and is therefore peculiarly subject to competitive attack."

"Companies which manufacture specialties that enjoy a ready market and are protected by patents or otherwise, from effective competition, may properly have a light operating ratio and an unusually large percentage of profits on sales."

See table, *Lough*, 512.

XVI

New Promotions

1. *General Considerations.*

Collver, 189-200; *Jordan*, 362-367; *Cooper*, 48-108, 414-429, 503-509; *Lough*, 236-237, 246-249.

In every general business boom thousands of fraudulent new securities are issued by a multitude of "fly-by-night" promoters. Such offerings appeal to the unreasoning greed of the unwary. However, the loss to the impecunious multitude who believes that purchasing the "unusual opportunity" is actually *investing*, is so great as to be a serious economic loss to the country, as well as to the individuals directly affected, not to consider the loss of business to legitimate investment dealers.

It is dangerous to capitalize a new proposition on a basis of business and earnings possible, or even actual, in boom times. Moreover, assets, even at bona-fide valuations, may appear excessive later on.

Some must pioneer, but unless one can well

afford the chance, and is well informed in regard to every phase of a new proposition, particularly in regard to its management and the offering house, a new promotion may usually be neglected without ultimate regret.

A large part of new propositions involve re-capitalization of old-established businesses. New securities so based, and offered by experienced and reputable houses, are not to be considered "New Promotions," although if the new financing provides for unwarranted expansion, difficulties may arise.

Citations as to success of other ventures nearly always simply "bait"—difficulties in the early experiences of enterprises widely heralded by the "get-rich-quick" fraternity.

Most certain indication of "promotion" stock is statement that reflects against Wall Street banks and methods. Wall Street is not perfect, but few if any security advertisements or circulars abusing "Wall Street" will stand analysis.

Unless a new promotion is well sponsored, doubt must be dispelled in regard to the most elementary statement on the prospectus. Many cases have arisen of corporation issues having been floated on the representation of ownership of plants which were simply optioned or not controlled at all.

In many instances, within a year or two after the flotation of a speculative "promotion" stock, not only will no market be avail-

able for the "securities" but no information will be available as to conditions affecting them. For example, a stock was widely marketed not long ago as high as more than \$50 a share, on indications of huge earnings. A request for information recently was met by the following: "In view of our desire to forestall any activity in the market at this time we are issuing no detailed statements regarding the present financial status or future earnings of the corporation."

Price below par is a common lure—little difference as to the price common stock is sold originally as a rule—if enough is sold to meet requirements. May legitimately be sold "Part paid" and calls made as necessary.

Stock sold to the public is often "bonus stock" given to the promoter. In such case the sale does not benefit the company's treasury. Good management the first consideration. Possibility that earnings be absorbed by "insiders."

Seldom profitable to buy new securities simply because issued by new *local* enterprise.

2. *Special Information Tests in re New Promotions.*

Listing Statement requirements. Call attention to much important definite information—but no responsibility is taken for such statements.

Prospective purchaser should ascertain

whether Balance Sheet submitted is before or after receipt of funds from sale of securities offered. Should be certain that full capital requirements have been *underwritten* by responsible houses.

Unreasonable percentage of security receipts taken by "promotion" security houses, which may vanish after a security "goes wrong."

"Cellar-garret level." *Collver*, 200-204.

Inadequacy of state "Blue-Sky" Laws. Ease of evasion. Danger to investor and legitimate investment dealer. Suggestions for a reasonable and protecting Federal Law. Annals. Annals—*Reed*, 177-187.

Text of Blue-Sky Laws of the different States. *Elliott and Rollins-Spring*.

Summary of Blue-Sky Laws. *Reed, Dougherty, & Hoyt*.

Digest of provisions of the British Companies Act. *Collver*, 201-202; *Tovey*—Prospectuses, 59-66 gives important paragraphs in full.

Federal Trade Commission Query. Does not provide for information in the future, but publicity of information required by such a Query would revolutionize questionable security practices which have not changed in hundreds of years. Text of Query given in *Collver*, 205-208.

XVII

Receiverships and Reorganizations

Unfortunately space is lacking for detail in regard to these subjects. Valuable material is easily available as to Causes of Receivership, Purpose of Reorganization, Method of Effecting Reorganizations, Effect on Securities, etc.

The entire text of *Dewing* is of great value. This book includes the history of some twenty large companies which passed through receivership and reorganization, with special chapters on "The Promotion of Consolidations which have undergone Reorganization," "Causes leading to Reorganization," and "Reorganization Expedients."

Other sources of importance are *Lough*, 573-616; *Gerstenberg*—Principles, 170-182.

Haney, 327-341; *Jordan*, 351-361; *Lyon*, II, 221-307.

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PRINCIPAL SOURCES OF INFORMATION

I. PRINCIPAL SOURCES OF INFORMATION IN REGARD TO INDIVIDUAL INDUSTRIAL CORPORATIONS

1. Annual manual and book of "Analyses": former by Poor's Publishing Company, the latter by Moody's Investors Service. Manual of Statistics. Annual Manual of Statistics Company.
Fitch Publishing Company Bond Book-annual with weekly revisions.
Standard Statistics Company stock and bond cards with supplemental news service. Poor's news service of corporations.
2. Corporation Annual Reports. Of particular value. Often contain valuable information which commercial publishers of information cannot be expected to furnish. Digest at least usually found in Financial Chronicle.
3. Corporation Quarterly and Interim Statements. Usually available in financial dailies, and sent direct to stockholders. Found in Financial Chronicle.
4. Security Circulars issued by investment houses many times give information nowhere else available—as well as the latest financial reports.
5. Statistical Departments of interested security houses.
6. Special analyses issued by security houses and by financial service organizations.
7. Financial periodicals, financial special and general newspapers. Digest of news in Financial Chronicle.
8. Special semi-annual Railway and Industrial supplement of the Financial Chronicle.

9. Periodicals—Trade. Of great value and importance. Every industry has one or more trade papers, i.e., on iron and steel, leather, paper, etc. They contain general and specific articles of interest to the holder of securities in the various industrial lines.
10. Miscellaneous Sources of Information.
 - a. Indentures; obtainable from security house interested, from trustee of security or direct from corporation.
 - b. Stock Exchange Listing Sheets. For listing requirements of the New York Stock Exchange see the Stock Exchange Business. Investment Bankers' Association, Pages 27-30, Lyon, II, 157-174; and Gerstenberg—Materials, 151-161.
 - c. National and local credit agencies.
 - d. Not the least important information source is the company direct. Very often corporation officials will freely give out information in regard to any phase of its activities or condition—information which for some reason or other—or for no special reason has not been made public.
 - e. State publications, e.g., Massachusetts, which requires submission of information by all corporations permitted to engage in business within that commonwealth.

For details in regard to much of the above see Jordan, 395-412.

For books dealing with special lines of industry-processes, etc., consult catalogues of large public libraries.

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NOTE: Certain balance sheet and balance sheet schedule accounts require little explanation. For those not directly indexed see index reference to main headings on pages 38 and 39.

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